No. 10061

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant

vs.

THE COAST WINERIES, Inc., a corporation, and UNITED STATES FIDELITY AND GUARANTY COMPANY, a corporation,

Appellee.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

HONORABLE JEREMIAH NETERER, *Judge*

REPLY BRIEF FOR APPELLANT

JOSEPH LAWRENCE,
Director, Bond and Spirits Division, Department of Justice.

BENJAMIN H. PESTER,
Chief, Bond and Tax Section.

J. CHARLES DENNIS,
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PREFACE

The record clearly shows that there has been no hearing on the merits of the Government's claim either before the Special Master or the Court. The appellee does not seriously contend that there was a hearing on the merits but relies upon a legalistic application of the technical rule of res judicata.

We deem it necessary to file a reply brief for the purpose of clarifying the position of the appellant and distinguishing it from that of the appellee.

RES JUDICATA

Simply stated, the position of the appellant is that in the first instance the claim in the sum of $9,387.21 was withdrawn by the Government as abated, although the record (R. 151) shows that, in fact, no part of the $9,387.21 tax assessment then had been abated and that not until March 15, 1937, did the Commissioner of Internal Revenue adjudicate the tax claim by allowing $6,224.65 and rejecting the abatement as to the $3,162.56 which remained on the assessment books of the Collector as an unpaid tax assessment. The order of the District Court dated December 21, 1936, relating to the $9,387.21 tax claim, merely confirmed the report of the Special Master that this claim had been withdrawn as abated on October 15, 1936 (R. 65-66). There was nothing before the Special Master or the District Court to pass upon relative to the merit of this claim or any part thereof. Thus there was no hearing or merit consideration of the tax or any part thereof by the Court.

The second claim was filed for the $3,162.56 tax and the same was presented to the Special Master and no request was made to the District Court to rescind its previous order. Being a part of the $9,387.21 previously expunged by the Court as withdrawn and abated, the Special Master recommended disallowance of same. Thereafter the District Court on November 12, 1937, approved this recommendation and expunged and disallowed the $3,162.56 claim because "it was and is a part of the $9,387.21 claim previously expunged as abated and withdrawn." Thus on the second claim there was no hearing on the merits nor was it in fact properly before the Special Master or the District Court for consideration since no motion or request had been filed with the District Court for leave to reinstate the $3,162.56 claim for consideration in the bankruptcy proceedings. Regarding this, the case of *In re Universal Rubber Products Co.*, 25 F. (2d) 168, cited by appellee in its brief, pages 20, 21, 22, is interesting. In the quotation at page 22 one of the bases for refusing to allow the setting aside of a previous order at the request of the trustee, the Court stated:

> "The trustee in bankruptcy does not ask to have this order rescinded. * * *."

The claim was not provable before the Special Master who was bound by the prior order of the Court regarding the $9,387.21 claim as an abated and withdrawn tax.

The appellant concedes that a judgment which is res judicata in favor of the principal on a bond and which said judgment relieves the principal of his bond liability also relieves the surety from its liability on the bond. That, however, is not this case. The only action which the Government officers took related to the tax assessment and the withdrawal from the bankruptcy proceedings of the tax claim filed therein. This action precluded the Government insofar as the bankruptcy proceedings are concerned and it cannot share in the estate of the bankrupt. In the case at bar the Government's remedy is on the bond and the conclusion of the tax claim in the bankruptcy proceedings does not bar recovery because the claim was not passed upon on its merits.

The appellee's contention that the cases cited by appellant involve bonds given by a taxpayer to stay the collection of an income tax has no application to *U. S. v. Barth Company*, 279 U. S. 370. The Barth Company had given a bond guaranteeing the payment of the tax on distilled spirits, as provided by law, and

upon failure by the taxpayer to pay the tax the Government was allowed recovery under the bond.

In *U. S. v. Frost, et al*, 80 Fed. (2d) 341, the Fifth Circuit Court of Appeals held that the bond was the primary obligation and not ancillary to the obligation for the payment of taxes or penalties. In *U. S. v. Frank Bornn*, 104 Fed. (2d) 641, the Second Circuit Court of Appeals allowed recovery under the bond but reversed the judgment insofar as the tax liability of the principal was concerned and the Supreme Court of the United States in *U. S. v. Rizzo*, 297 U. S. 530, held that the Government might have several remedies in the same case and could pursue either one or all of them. In the case at bar the Government's remedy insofar as the collection of the tax from the bankrupt estate is concerned, has been concluded; but such conclusion in the bankruptcy proceedings did not pass upon the merits of the claim and does not bar recovery under the bond in this suit.

Counsel for the appellee contends that the bond is ancillary to the liability of the principal and to support this view they cite *U. S. v. Springer & Lotz, et al* 69 F. (2d) 819 (C.C.A.2). However, the Second Circuit Court of Appeals expressly overruled that de-

cision in its opinion in *Durning v. McDonnell*, 86 Fed. (2d) 91, in the following language:

> "The appellants rely upon our decision in *United States v. Springer & Lotz*, 69 F. (2d) 819. We did not there hold that section 791 applied to an action on the bond; in fact, we said it did not. We held that though the action was brought in time, it failed on the merits because the penalties must themselves be 'payable' to be within the coverage of the bond. If that holding were still good law, the appellants should prevail, but it can no longer be sustained in view of the Supreme Court's ruling in *United States v. Mack*, 295 U. S. 480, 55 S.Ct. 813, 79 L.Ed. 1559."

In our opinion the controlling case on the subject is *U. S. v. American Surety Company* (C.C.A.2) 56 Fed. (2d) 734, cited and discussed in the appellant's original brief. The appellee ignores this decision entirely although in that case a claim had been filed in the bankrupt estate of the principal and denied and recovery was allowed from the surety in a suit on the bond.

The citations by appellee in its brief relate to cases where there had been a determination on the merits and a failure on the part of the plaintiff or defendant to raise some legal defense or basis of action. In those cases the doctrine of res judicata properly applied and prevented a subsequent suit upon

the same cause of action. Here, as has been shown, there was no trial on the merits and, therefore, the doctrine has no application under the facts in this case.

ESTOPPEL

Appellee contends that the Government takes the position that it cannot be estopped by the acts of its agents. This interpretation, however, is erroneous. It is our contention that anyone who asserts the acts of Government agents as the basis for estoppel must show that the acts were within the scope of the authority of the agents. See *Royal Indemnity Co. v. U S.*, 313 U. S. 289, cited in appellant's original brief.

The evidence relating to the alleged agreement between counsel for the Trustee in Bankruptcy of The Coast Wineries, Inc., and Mr. Winter, attorney for the Government, has been sufficiently discussed in appellant's original brief. Appellant discussed the pleading at length in its original brief because no agreement was pleaded. Therefore, evidence concerning same is irrelevant, incompetent, and immaterial. However, should this Court consider such evidence admissible, the record clearly shows that no agreement was entered into. However, should the Court find that the conversations amount to an agreement, then, before

such agreement can be binding upon the Government, there must be a finding that Mr. Winter had authority to make it. That Mr. Winter had no such authority see *Royal Indemnity Co. v. U. S., supra.*

Furthermore, the only action taken by the agents of the Government, which might constitute estoppel, was in regard to the bankruptcy proceedings and there is nothing in the record to show that the surety company at any time received notice from a Governmental agent or agency that it was relieved of liability under its bond. The evidence shows that the information obtained by the surety came through Judge Grady, counsel for the trustee, and the action taken by the bonding company relating to its indemnitors was based on this oral statement by counsel for the trustee in face of a written notice, dated June 6, 1935, from the District Supervisor, Alcohol Tax Unit, that the bond was in jeopardy (R. 121 and 122). The record reveals nothing from a Government officer withdrawing this notice.

During the period of time in controversy, the record (R. 153) clearly shows that the tax sought to be recovered in this action at all times remained as a charge against the principal on the assessment books

of the Collector of Internal Revenue. Had the appellee, who now seeks to invoke the doctrine of equitable estoppel, used due diligence, the fact that this assessment remained outstanding could readily have been determined by proper inquiry.

Appellee cites *United States v. Alexander*, 110 U. S. 325, as authority for estoppel by action of Government officers. That case is readily distinguished from the one at bar. In that case a tax had been assessed against a distiller and the Secretary of the Treasury had approved the abatement of the tax, sent notice thereof by schedule to the Collector of Internal Revenue, and the tax was abated and removed from the assessment records of the Collector. Thereupon, notice that the tax had been abated was given the principal on the bond and the principal notified the surety that its obligation no longer existed. Later the Secretary of the Treasury reassessed the tax and sought to hold the bonding company but the Supreme Court held that it was estopped to make such claim against the bonding company by reason of the previous action in abating the tax. In the instant case there was in fact no abatement of the $3,162.56 tax and although the Collector had erroneously advised the Special Master on October 15, 1935, that "We have abat-

ed the above tax and are withdrawing our proof of claim covering same," the Commissioner of Internal Revenue had, in fact, not abated the tax and the assessment at that time remained outstanding on his books. The Collector of Internal Revenue, in his letter of October 15, 1935, was referring to the $9,387.21 tax assessment which included the $3,162.56 tax made the subject of the present suit and which never was abated. As stated in the Government's original brief, the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is the only official in the United States Government authorized to abate a tax.

CONCLUSION

It is respectfully submitted that the proceedings heretofore had in connection with the claim involved in this suit did not decide the merits of the claim and are, therefore, not res judicata, and the facts in the record do not show such action on the part of authorized Government agents which constitute an estoppel. The judgment of the Court below should be reversed and judgment entered for the plaintiff in the sum of

$3,162.56, plus the statutory 5 percent penalty and interest, as prayed for in the complaint.

July, 1942.

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